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# Estimating workers' marginal valuation of employer health benefits: Would insured workers prefer more health insurance or higher wages?

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**Abstract**

In recent years the cost of health insurance has been increasing much faster than wages. In the face of these rising costs, many employers will have to make difficult decisions about whether to cut back health benefits or to compensate workers with lower wages or lower wage growth. In this paper, we ask the question, "Which do workers value more—one additional dollar's worth of health benefits or one more dollar in their pockets? " Using a new approach to obtaining estimates of insured workers' marginal valuation of health benefits this paper estimates how much, on average, employees value the marginal dollar paid by employers for their workers' health insurance. We find that insured workers value the marginal health premium dollar at significantly less than the marginal wage dollar. However, workers value insurance generosity very highly. The marginal dollar spent on health insurance that adds an additional dollar's worth of observable dimensions of plan generosity, such as lower deductibles or coverage of additional services, is valued at significantly more than one dollar.


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Dramatic changes in the U.S. health insurance market over the last two decades have had an enormous impact on our system of employer-provided health insurance. Employers have confronted soaring health insurance costs, a significant increase in the variety of health plans available, and substantial changes to public insurance programs. Of all of these changes, the increases in

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the cost of health insurance are certainly at or near the top of the list of health insurance worries. The New York Times (August 19, 2004) cites the “relentless rise in the cost of employee health insurance” and quotes experts who blame health insurance cost growth for the lack of job growth (Porter, 2004). In an Issue Brief, the Center for Studying Health System Change highlights employers’ pessimism about acceptable responses to the upward trend in insurance costs: “most employers see no viable alternatives on the horizon” (Regopoulos et al., 2004). Employers and policymakers face some difficult tradeoffs as they seek the optimal response with respect to health insurance offerings in this new health insurance environment, especially given the expectation of continued cost growth substantially greater than inflation.

In the face of these rising costs, many employers will have to make difficult decisions about whether to cut back health benefits or to compensate workers with lower wages or lower wage growth. Policymakers may consider options such as mandated employer-provided coverage or minimum coverage levels for those offered insurance. As employers and policymakers confront these difficult choices, they need estimates of how much workers value an additional dollar in health benefits as compared to an additional dollar in wages. Which do workers value more—one additional dollar’s worth of health benefits or one additional dollar in their pockets?

Using a new approach to obtaining estimates of insured workers’ marginal valuation of health benefits, this paper estimates how much, on average, employees value the dollars employers pay for their workers’ health insurance. However, health insurance premiums vary for a number of reasons, not all of which may be expected to generate value to a worker. Premiums reflect not only the generosity of the coverage but also factors such as administrative costs, competition, and risk selection. There is no reason to expect that workers value premium dollars spent on these other items. In the second part of the paper, we distinguish between worker valuation of premium dollars that reflect insurance generosity and premium dollars that reflect these other factors.

We find that insured workers value the marginal health premium dollar at significantly less than the marginal wage dollar. However, workers value insurance generosity very highly. The marginal dollar spent on health insurance that adds an additional dollar’s worth of observable dimensions of plan generosity, such as lower deductibles or coverage of additional services, is valued at significantly more than one dollar.

## 1. Conceptual framework

Before presenting an intuitive explanation of how we estimate the value to workers of additional dollars spent on health insurance, it is useful to discuss why that valuation is not necessarily simply equal to one. Although a tradeoff equal to unity may be a natural focal point, there are many reasons why the tradeoff between wage dollars and health benefit dollars may not be one-for-one. The tax advantaged status of fringe benefits relative to wages suggests that each dollar of health benefits may be worth more than a dollar in wages to employees since the health benefits dollars are not taxed. On the other hand, economists would generally expect wage dollars to be valued more highly by employees than dollars paid in in-kind benefits since workers’ preferences for those in-kind benefits are likely to vary. Although worker preferences affect health plan offerings, a firm offers some limited number of health plans and cannot expect to satisfy exactly the preferences of all employees (Moran et al., 2001; Bundorf, 2002). Yet, health insurance also differs from many other in-kind benefits because the same insurance can usually be purchased at much lower cost through an employer group than individually. This would push valuations of benefits relative to wages higher. It is also not obvious that employers will not offer health benefits if workers value dollars spent on health insurance less than wage dollars. It is possible that health insurance